

# OFFICE OF INSPECTOR GENERAL

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## *Inspections Report*

Accounting for Residual Assets--RTC  
Newport Beach and Denver Offices and  
Denver Financial Service Center

INS-96-006

April 5, 1996



This report presents the results of inspection work conducted by the Resolution Trust Corporation (RTC) Office of Inspector General. December 31, 1995, marked the Corporation's legislatively mandated sunset date. Responsibility for all RTC-related work ongoing as of that date was transferred to the Federal Deposit Insurance Corporation (FDIC), in accordance with the RTC Completion Act of 1993. Thus, FDIC's Office of Inspector General is issuing this report.



Federal Deposit Insurance Corporation

Washington, D.C. 20429

Office of Inspector General

**DATE:** April 5, 1996

**TO:** Jim Densmore  
Assistant Director  
Denver Financial Service Center

**FROM:** Stephen M. Beard  
Deputy Assistant Inspector General for Inspections

**SUBJECT:** *Accounting for Residual Assets--RTC Newport Beach and Denver Offices and Denver Financial Service Center (INS-96-006)*

This report presents the results of our review of the Resolution Trust Corporation's (RTC) accounting for assets that were created as a result of RTC disposition actions, called residual assets. We initiated this review as a result of a similar review by the RTC Office of Inspector General (OIG), Office of Audit, at the Kansas City Office and Financial Service Center (FSC). The objectives of our review were to determine whether RTC's Newport Beach and Denver Offices and the Denver FSC had adequate controls to (1) account for residual assets, and (2) ensure that Internal Revenue Service (IRS) Form 1099 was properly filed when required.

We found that RTC was generally recording residual assets properly and according to RTC procedures. Following a review of a sample of residual asset transactions with favorable results, we determined that there was not a sufficient basis to conduct the full intended scope of our review. In addition, because of the positive conditions identified, we made no recommendations to FDIC with regard to accounting for RTC residual assets.

We did not perform the second objective because we ended this review early and because many of the cases in our sample were consummated before RTC was required by law to file IRS Forms 1099 to report debt forgiveness.

On March 18, 1996, we provided FSC management with a draft of this report. FSC management indicated it had no comments on the information presented.

The Inspector General Act of 1978, as amended, requires OIGs to report on the status of management decisions on their recommendations in their semiannual reports to Congress.

Because this report does not contain formal recommendations, a management decision is not needed to meet the requirements of the act.

## **SUMMARY OF FINDINGS**

For those residual asset transactions that we reviewed, we found that the Denver FSC generally recorded residual assets correctly. The creation of new assets was identifiable in RTC's general ledger or other supporting documents. Further, the resulting journal entries usually followed RTC-established criteria. Of the 60 residual assets reviewed, we identified one asset that may not have been recorded. In this instance, the Denver FSC may not have recorded an asset derived from a foreclosure transaction executed by the lead participant to a participation loan. As discussed later, there were extenuating circumstances associated with this transaction and RTC ultimately recovered the its share of the proceeds from the sale of this asset by the lead participant. Accordingly, while RTC's asset inventory may have been misstated, it appears there was no overall financial impact. Further, because the Denver FSC properly recorded all other foreclosure transactions we reviewed, this matter did not appear to be indicative of a systemic problem.

## **SCOPE OF REVIEW**

To accomplish our objectives, we reviewed 60 residual assets created from committee case decisions from the former RTC Newport Beach and Denver Offices. The book values of these residual assets totaled almost \$197 million. We first determined that approved case actions were implemented and resulted in residual assets. We then reviewed journal entry and other supporting documents to determine whether derived residual assets were recorded properly.

We selected Credit Review Committee cases approved at the Newport Beach and Denver Offices during the period 1991 through early 1995. We identified 316 cases with potential residual asset implications for further review. Because of differences between field office reporting systems, we had to use slightly different methodologies at each office.

In Newport Beach, the field office provided a log listing all cases approved under Delegation of Authority A1--Compromise with book values over \$100,000. The log listed about 720 cases during the period 1991 through early 1995. We selected a sample of cases and then over-sampled in the event that some cases were never consummated. We reviewed each sample case and eliminated those cases that did not appear to result in residual assets. This methodology yielded 119 cases with possible residual assets for review.

The Denver Office was unable to separate A1--Compromise cases from other cases approved under delegated authority. However, the case logs contained more detailed descriptions which made it easier to identify cases with potential residual asset implications. Accordingly, we did not begin with a random sample of cases. Instead, we reviewed the case log and

identified all cases that appeared to result in residual assets. We reviewed each case and eliminated those cases that did not appear to result in residual assets and those cases that involved assets with book values less than \$500,000. This methodology yielded 197 cases with possible residual assets for review. We later eliminated Newport Beach and Denver cases with book values less than \$1 million.

The next step was to determine whether cases in our sample had been "consummated," or, in other words, approved actions were actually implemented. We determined consummation through research with the field offices, review of supporting case documentation, and review of RTC systems such as the Asset Manager System (AMS) and the Real Estate Owned Management System (REOMS). As a result of these efforts, we identified about 92 cases that were consummated.

Finally, we provided consummated cases to the Denver FSC for detailed journal entry review. We requested that the Denver FSC provide: (1) journal entry information showing that each residual asset had been recorded properly, and (2) source documentation such as a deed or promissory note as evidence of the new residual asset. We sent 33 cases with aggregate book values of \$255 million for journal entry research. Denver FSC staff was able to perform journal entry research on 26 cases. We limited our review to transactions that should have been recorded at the FSC. Accordingly, the resolution or status of several cases was not readily determinable because they involved subsidiary assets that would not have been recorded by the FSC, or case actions that were still in process.

We also reviewed journal entry documentation for four cases without the FSC's assistance. In these instances, journal entry information was included in the case supporting documentation. Because we terminated this review early, we did not determine the consummation status for 95 cases in our sample with aggregate book values of \$785 million.

In the end, we reviewed supporting journal entry information for 30 cases resulting in 60 residual assets. Table 1 on the next page summarizes our selection and review methodology.

**Table 1: Number and Book Values (BV) of Cases Selected and Reviewed in Newport Beach and Denver**

Extent of Review	Newport Beach		Denver		Total	
	Cases	BV (in millions)	Cases	BV (in millions)	Cases	BV (in millions)
Consummation Determined	21	159	71	468	92	627
Consummation Status in Question	4	53	17	86	21	139
Non-Residual Asset Cases <sup>a</sup>	40	304	68	377	108	681
Consummation Not Determined	54	531	41	254	95	785
Total Cases Initially Selected for Detailed Review	119	1,047	197	1,185	316	2,232
RTC Journal Entry (JE) Research	12	92	21	163	33	255
Plus OIG JE Research	0	0	4	25	4	25
Total JE Research	12	92	25	188	37	280
Less JE Cases Without Residual Assets	2	16	5	43	7	59
JE Cases with Residual Assets	10	76	20	145	30	221

<sup>a</sup> We excluded those cases which were duplicate or superseded, did not result in residual assets, or involved conservatorship or subsidiary assets that would not be recorded on RTC's general ledger.

We conducted our review at RTC's Newport Beach Office, Denver Office, and Denver FSC between January 1995 and February 1996. This review was suspended on several occasions to complete other higher priority reviews. The review was further delayed because of the nature and extent of research involved to determine whether cases were consummated and to locate and retrieve journal entry information. We conducted this review in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*.

## **BACKGROUND**

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) established RTC to manage and resolve failed savings institutions and to recover funds through the management and disposition of assets. Over its life, RTC disposed of almost \$223 billion in loan assets. In many instances, new residual assets were created as a result of RTC actions. For the purposes of this report, residual assets are defined as any new assets created by RTC actions during the management and disposition process. Examples of actions which resulted in residual assets included foreclosures, which resulted in real estate owned (REO) and possible deficiency assets, and sales of assets with new or extended financing, which resulted in new loans. Residual assets also included judgements and other assets received by RTC under settlement agreements.

RTC asset managers and asset management contractors began the process of creating residual assets by developing asset management and disposition plans and committee cases which requested authorization to pursue specific actions, such as a foreclosure or loan settlement. If these requests were approved and the specific actions were initiated, the approved case decisions and other supporting documentation were forwarded to the Asset Operations and Accounting Departments in the FSC for document verification and posting to RTC's General Ledger.

RTC issued Manual 4300.8, *Business Events Documentation Guide*, dated April 26, 1993, to establish documentation requirements for various transactions. Examples of documentation for loan disposition include the approved cases or asset management and disposition plans, asset source documents such as a deed of trust, REOMS and AMS information, and written instructions. If supporting documentation requirements were met, the transaction was recorded in the General Ledger using the documentation provided. RTC issued Manual 4300.4, *Field Accounting Manual*, dated May 8, 1992, to provide consistent policies and procedures for recording transactions.

## **RTC RECORDED RESIDUAL ASSETS PROPERLY**

The Newport Beach and Denver Offices and Denver FSC properly identified and recorded 59 of the 60 residual assets created in the 30 committee cases we reviewed. While one residual asset may not have been recorded, there appeared to be no resulting financial impact to RTC.

Overall, the bulk of the residual assets we reviewed were created through foreclosure and deed-in-lieu of foreclosure actions. A number of assets were also created through the restructure or issuance of promissory notes. Finally, several residual assets were created from the establishment of deficiencies and the award of court judgements. Table 2 presents the composition of residual asset types and aggregate book values in our sample.

**Table 2: Composition of Residual Assets Reviewed**

Type of Residual Asset	Number of Assets	Book Value of Assets (in millions)
REO Resulting from Foreclosure	29	\$84.1
Promissory Notes	16	42.0
Judgements/Deficiencies	13	65.6
Other	2	5.2
Total	60	\$196.9

While it appears RTC generally recorded residual assets properly, we identified one residual asset that may not have been recorded. This asset, Woodhaven Heights, was a \$6.5 million loan, originated in August 1983. The loan was secured by an apartment complex in Dallas, Texas. In December 1983, the lender, Vernon Savings and Loan Association (Vernon) sold a 76.9 percent participation interest in the loan to Sandia Federal Savings and Loan Association (Sandia). Vernon retained lead participant status.

Vernon failed and was placed in receivership with the Federal Savings and Loan Insurance Corporation (FSLIC). FSLIC, as Receiver for Vernon, foreclosed on the asset in June 1989. Following the passage of FIRREA, FDIC acquired the asset in August 1989. FDIC sold the Woodhaven REO in February 1992 and accepted a \$1.95 million seller financing note. In October 1993, FDIC sold the loan in a bulk sale at a premium. In October 1994, FDIC forwarded \$1.5 million to RTC, representing 76 percent of the sales price of the seller financed loan.

Sandia, the junior participant, failed and was placed in receivership under RTC's control in March 1991. On July 15, 1994, RTC approved a Credit Review Committee case for Woodhaven Heights which authorized RTC to: (1) ratify the June 1989 foreclosure, (2) ratify the sale of the REO with seller financing, and (3) accept \$1.5 million from FDIC as total compensation for Sandia's participation interest. Accordingly, the case created two residual assets--the foreclosure and the seller financed note. We submitted this case to the Denver FSC and requested copies of the journal entries recording RTC's participation interest in the foreclosure and seller financed loan, and receipt of final payment from FDIC.

RTC did not provide a journal entry or any other evidence supporting that the foreclosure had been recorded in RTC's general ledger. RTC did provide a journal entry, dated September 27, 1994, that wrote off the entire original loan participation balance for Woodhaven Heights.

With respect to the seller financed loan, RTC did not provide the journal entry initially recording the seller financed loan. However, the FSC did provide a later journal entry applying the loan sale proceeds to the seller financed loan, indicating that the loan had been recorded. RTC also produced a copy of a \$1.5 million check from FDIC, dated October 18, 1994, for RTC's portion of the loan sale. RTC apparently recorded the receipt of the loan sales proceeds properly.

RTC's Manual 4300.4, *Field Accounting Manual*, originally dated May 8, 1992, provided standard accounting policies and procedures to assist in the performance of accounting functions. The Manual included a section on accounting for REO and stated REO for a liquidating financial institution could already exist on the institution's books before it was closed or result from RTC initiated actions such as, foreclosure, deed-in-lieu of foreclosure, and discovery of the REO property during detailed review of the institution's records after closing. From the information provided, we could not determine whether Sandia or RTC failed to record the effects of the June 1989 foreclosure on its books. Accordingly, we could not determine whether the FDIC's foreclosure should have been recorded as a foreclosure or as a discovered asset in RTC's general ledger. The ratification action in the case appeared to authorize recording the transaction as a foreclosure. According to the *Field Accounting Manual*, if the subject loan was a participation loan and RTC was not the lead participant, the action should have been recorded as a regular (non-participating) foreclosure.

Because the foreclosure was apparently not recorded following the ratification case, RTC's asset inventory may not have properly reflected the Woodhaven Heights asset. Nevertheless, it appears that RTC did record the seller financed loan and RTC did receive and record the sales proceeds from FDIC's sale of the loan. Accordingly, there did not appear to be an overall financial impact from RTC's failure to record the foreclosure.

We could not readily determine why this asset was not recorded, although extenuating circumstances could have contributed to this oversight. The foreclosure occurred prior to RTC intervention, and for that matter, RTC's existence. Moreover, RTC was not the lead participant. Perhaps as a result of communications from FDIC, RTC eventually determined that a foreclosure had occurred and the Corporation prepared a committee case to ratify this action. However, for some reason, it appears the transaction was never recorded. We did not obtain pre-intervention financial records to determine whether Sandia properly classified the results of the foreclosure. We did not pursue this matter further, because: (1) the Denver Office had closed, (2) this oversight resulted in no apparent financial loss, and (3) this oversight did not appear to be indicative of a greater problem.

Because of the immaterial nature of this residual asset when compared to RTC's inventory of assets, we are not recommending that FDIC take any action with respect to the Woodhaven Heights foreclosure.



## **CONCLUSIONS**

During its life, RTC disposed of billions of dollars of loans from failed institutions. Several of RTC's forms of disposition resulted in the creation of new, residual assets. Because of the volume and complexity of these assets, risks existed that they would not be properly recorded. However, with respect to the 60 residual assets we reviewed, RTC properly identified and recorded the assets in all but one instance that had no apparent financial impact on the Corporation. Consequently, we are making no recommendations to FDIC with regard to accounting for RTC residual assets.

cc: Harry Smith  
Karyn Wolf